Comments should be submitted by 20 January 2016 to Commentletters@efrag.org

EFRAG's preliminary views set out for publication are accompanied by a large series of questions seeking input from constituents. Indeed, currently EFRAG is facing a significant diversity of views as to what alternatives, if any, should be proposed to the IASB, reflecting differences in assessment of the options proposed by the IASB. In its consideration of this complex issue, EFRAG is looking for facts and evidence supporting preferences that help finalise its comments and proposals to the IASB in as robust a manner as possible.

[Date]

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sir/Madam,

Re: IASB ED/2015/11 Applying IFRS 9 *Financial Instruments* with IFRS 4 *Insurance contracts*

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the Exposure Draft, ED/2015/11 *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance contracts*, issued by the IASB on 9 December 2015 ('the ED').

This letter is intended to contribute to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of definitive IFRS in the European Union and European Economic Area.

EFRAG appreciates the efforts of the IASB to address the concerns that the misalignment of the effective dates of IFRS 9 and the new insurance contracts Standard have brought. In its final endorsement advice on IFRS 9, EFRAG already noted that the misalignment of the effective dates of the two standards would cause additional accounting mismatches in profit or loss, be difficult for users to understand and lead to additional costs of implementation. EFRAG notes that the IASB is proposing an overlay approach and a temporary exemption from applying IFRS 9 to mitigate these concerns, both on an optional basis.

While the temporary exemption from applying IFRS 9 helps mitigate all the concerns of the misalignment of the effective dates of the two standards, the overlay approach helps neutralise in profit or loss the additional accounting mismatches that arise from the implementation of IFRS 9, without addressing the other concerns arising from the misalignment of the effective dates of the two Standards. Furthermore, the overlay approach generates supplementary costs of its own.

EFRAG has nevertheless been made aware that, given the diversity of circumstances among entities which issue insurance contracts within the scope of IFRS 4, the overlay approach is found to be a suitable approach for some banks which carry insurance activities. Indeed, for such entities, addressing the accounting mismatches without delaying the implementation of IFRS 9 may be the best option, despite the supplementary costs involved. Consequently, EFRAG agrees that both solutions should be pursued and should remain optional.

However, to avoid any possible breach in the level playing field among insurers, EFRAG considers that an optional temporary exemption from applying IFRS 9 should be made available to all insurers that issue a material amount of insurance contracts within the scope of IFRS 4. Furthermore, EFRAG considers that applying the temporary exemption from applying IFRS 9 should not run the risk of being extended to material non-insurance activities, in particular banking activities. For these reasons, EFRAG has concluded that the temporary exemption from applying IFRS 9 should be available both at and below the reporting entity level. EFRAG also considers that material banking activities should not be captured by the temporary exemption from applying IFRS 9. Proposals which are summarised below are made with these objectives in mind.

Temporary exemption from applying IFRS 9

To meet the above-stated objectives, EFRAG considers that the scope of application of the temporary exemption from applying IFRS 9 should be guided by the identification of “insurers” or “insurance activities” that are generally recognised as such in practice. EFRAG notes that the IASB has made an attempt at identifying “pure insurers”, acknowledging that their proposals would only capture a narrow population of “insurers”. Limiting the benefit of the temporary exemption to a narrow population only constitutes from EFRAG’s point of view a regrettable breach of level playing field. EFRAG therefore considers that IFRS 4 amendments should be finalised in a way that opens the temporary exemption to all entities that issue insurance contracts. EFRAG recommends that this is done on one of the two following possible paths, which we have called:

1- A widened “predominant activity” criterion however set at a higher level than proposed by the IASB; and

2- The “regulated entity” criterion.

We have detailed and justified our alternative proposals in Appendix 1 to this letter.

EFRAG understands the IASB’s arguments for limiting the temporary exemption from applying IFRS 9 at reporting entity level. However, EFRAG believes that ensuring no breach in level playing field in the insurance sector is paramount. In Appendix 1 we recommend how internal transfers should be accounted for in order to best avoid earnings management and why, in our view, the temporary breach in the uniformity of accounting policies is acceptable in the circumstances when the temporary exemption from applying IFRS 9 is applied below reporting entity level. Whilst we acknowledge it is not ideal, in our view it is the price to pay not only to avoid breaching the level playing field in the insurance sector but also to avoid capturing in the temporary exemption from applying IFRS 9 some material banking activities.

Sunset clause

EFRAG agrees that the temporary exemption from applying IFRS 9 should have an expiry date and supports that expiry date being set at 1 January 2021 on the assumption that the new insurance contracts Standard will be effective by that date. EFRAG supports that IASB focuses on finalising the new insurance contracts Standard and urges the IASB to ensure that the new insurance contracts Standard is effective by this date. Indeed, considering that entities that have opted for the temporary exemption from applying IFRS 9 might move to the overlay approach should not be regarded as a solution to a possible delay in the finalisation of the new insurance contracts Standard. Furthermore, the very significant improvements in financial reporting that are expected from the new insurance contracts Standard should not be delayed.

If you would like to discuss our comments further, please do not hesitate to contact Didier Andries, Sapna Heeralall, Joseba Estomba or me.

Yours sincerely,

Roger Marshall
Acting President of EFRAG Board

APPENDIX 1 – EFRAG's responses to the questions raised in the ED

Background information for EFRAG's constituents

1 *In July 2014, the IASB issued the completed version of IFRS 9. IFRS 9 sets out the requirements for recognising and measuring financial instruments. It replaces IAS 39 and has an effective date of 1 January 2018 with earlier application permitted.*

2 *The IASB is also at an advanced stage in its project to replace IFRS 4. However, the IASB is proposing to allow an implementation period of approximately three years after the publication of a new insurance contracts Standard. Hence, the earliest possible mandatory effective date of the new insurance contracts Standard will be after the effective date of IFRS 9.*

3 *Some interested parties, in particular insurers and their representative bodies, have suggested that the IASB should permit insurers to defer the application of IFRS 9 in order to align the effective date of IFRS 9 with the effective date of the new insurance contracts Standard.*

Question 1 – Addressing the concerns raised

Paragraphs BC9–BC21 describe the following concerns raised by some interested parties about the different effective dates of IFRS 9 and the new insurance contracts Standard:

(a) Users of financial statements may find it difficult to understand the additional accounting mismatches and temporary volatility that could arise in profit or loss if IFRS 9 is applied before the new insurance contracts Standard (paragraphs BC10–BC16).

(b) Some entities that issue contracts within the scope of IFRS 4 have expressed concerns about having to apply the classification and measurement requirements in IFRS 9 before the effects of the new insurance contracts Standard can be fully evaluated (paragraphs BC17–BC18).

(c) Two sets of major accounting changes in a short period of time could result in significant costs and effort for both preparers and users of financial statements (BC19–BC21).

The proposals made by the IASB are designed to address these concerns.

Do you agree that the IASB should seek to address these concerns? Why or why not?

Notes to constituents

4 *The following concerns have been raised about the different effective dates of IFRS 9 and the new insurance contracts Standard:*

(a) *Users of financial statements may find it difficult to understand the additional accounting mismatches and temporary volatility that could arise in profit or loss on application of IFRS 9 before the new insurance contracts Standard.*

(b) *Some entities that issue contracts within the scope of IFRS 4 have expressed concerns about having to apply the classification and measurement requirements in IFRS 9 before the effects of the new insurance contracts Standard can be fully evaluated.*

(c) *Two sets of major accounting changes in a short period of time could result in significant cost and effort for both users and preparers of financial statements.*

5 *The IASB proposes to address those concerns by the introduction of:*

(a) *An option for entities that issue contracts within the scope of IFRS 4 to reclassify, from profit or loss to OCI, some of the income or expenses arising from designated financial assets (the 'overlay approach'); and*

(b) *A temporary exemption from applying IFRS 9 for entities whose predominant activity is issuing contracts within the scope of IFRS 4. This temporary exemption from applying IFRS 9 is targeted at entities that would be identifiable as 'pure' insurers in that their predominant activity is issuing contracts within the scope of IFRS 4.*

EFRAG's response

EFRAG is appreciative that the IASB has considered the difficulties caused by the misalignment of the effective dates of IFRS 9 and the new insurance contracts Standard. In its endorsement advice on IFRS 9, EFRAG noted that the misalignment of the effective dates of the two standards would potentially cause additional accounting mismatches in profit or loss, be difficult for users to understand and lead to additional costs of implementation. EFRAG continues to have these concerns. Also, based on its outreach with individual analysts of insurance companies, EFRAG notes that a majority of them supported the application of the new insurance contracts Standard and IFRS 9 at the same time.

Question 1 (a)

6 During its outreach with individual users of the financial statements of insurance entities and in its participation in the outreach led by the IASB, EFRAG heard that a majority preferred that both IFRS 9 and the new insurance contracts Standard should be implemented by the insurance industry at the same time.

7 EFRAG agrees that the IASB should address the concerns identified in paragraphs BC9 – BC21 of the ED, due to the following reasons:

(a) Avoidance of temporary accounting mismatches causing volatility in profit or loss without economic substance;

(b) The difficulties of explaining this volatility to investors; and

(c) Avoiding the need for analysts' forecasting models to be changed more than once.

8 EFRAG notes that some analysts made their support for a temporary exemption from applying IFRS 9 conditional upon an interim period during which this temporary exemption being applied would not be too long (approximately 3 or 4 years). EFRAG is of the view that the risk of continuous application of the temporary exemption from applying IFRS 9 is adequately addressed through the introduction of a sunset clause as discussed in our answer to Question 6 below.

Questions 1 (b) and 1 (c)

9 EFRAG's endorsement advice on IFRS 9 reflects its analysis of the effects of the misalignment of the effective dates of IFRS 9 and the new insurance contracts Standard. It is available on the EFRAG website at http://www.efrag.org/files/IFRS%209%20endorsement/IFRS_9_Final_endorsement_advice.pdf.

10 EFRAG is therefore appreciative that the IASB has acknowledged the difficulties arising from the misalignment of the effective dates of IFRS 9 and the new insurance

contracts Standard and is proposing two options that are designed to address the concerns.

Question 2 – Proposing both an overlay approach and a temporary exemption from applying IFRS 9

The IASB proposes to address the concerns described in paragraphs BC9–BC21 by amending IFRS 4:

(a) to permit entities that issue contracts within the scope of IFRS 4 to reclassify from profit or loss to other comprehensive income, some of the income or expenses arising from designated financial assets that:

  (i) are measured at fair value through profit or loss in their entirety applying IFRS 9 but

  (ii) would not have been so measured applying IAS 39 (the 'overlay approach') (see paragraphs BC24–BC25);

(b) to provide an optional temporary exemption from applying IFRS 9 for entities whose predominant activity is issuing contracts within the scope of IFRS 4 (the 'temporary exemption from applying IFRS 9') (see paragraphs BC26–BC31).

Do you agree that there should be both an overlay approach and a temporary exemption from applying IFRS 9? Why or why not?

If you consider that only one of the proposed amendments is required, please explain which and why.

Notes to constituents

<u>*Overlay approach*</u>

11 *The IASB noted that additional accounting mismatches and temporary volatility that may arise on the application of IFRS 9 could be dealt with by amending IFRS 4 to permit entities to adjust pre-tax profit or loss to offset the effect of financial assets that would be measured at fair value but would not have been measured this way in accordance with IAS 39. Such an approach would:*

(a) *Ensure that the improvements in accounting for financial instruments introduced by IFRS 9 are implemented on a timely basis;*

(b) *Provide information about financial instruments comparable with the information that is provided by other entities that apply IFRS 9;*

(c) *Ensure that all financial instruments within a reporting entity are reported consistently in accordance with IFRS 9;*

(d) *Be effective in reducing accounting mismatches for participating and non-participating contracts and eliminate the additional volatility in profit or loss arising from applying IFRS 9; and*

(e) *Provide additional information to users helping to them to understand the effects of IFRS 9, in contrast to the temporary exemption from applying IFRS 9.*

12 *The IASB acknowledges that adjusting profit or loss to offset the effects of IFRS 9 in accordance with the overlay approach would require insurers to identify and track financial assets measured at fair value through profit or loss in accordance with IFRS 9 that would not have been measured at fair value through profit or loss in their entirety in accordance with IAS 39. Thus, applying the overlay approach would require operational change. However, the IASB concluded that, compared to other approaches, the advantages of the overlay approach for users of financial*

statements would outweigh any potential costs associated with the required operational change.

<u>Temporary exemption from applying IFRS 9</u>

13 *Some interested parties have suggested that the IASB should permit insurers to be temporarily exempted from applying IFRS 9 until the new insurance contracts Standard is effective. Such an approach would appear to be a simple way of dealing with most of the concerns expressed by interested parties. However, the IASB concluded that a temporary exemption from applying IFRS 9 should not be provided for all entities that carry out insurance activities because:*

(a) *IFRS 9 introduces significant improvements in accounting for financial instruments; and*

(b) *A temporary exemption from applying IFRS 9 for insurers could create a different set of added costs and complexities for both preparers and users of financial statements by reducing comparability in the accounting for financial instruments.*

14 *The IASB noted that limiting the temporary exemption from applying IFRS 9 to a relatively small population of entities who are most affected by the different effective dates of IFRS 4 and IFRS 9, the problem of reduced comparability for users of financial statements would be reduced.*

15 *Accordingly, the IASB decided, on balance, to propose a temporary exemption from applying IFRS 9 for some insurers (i.e. the ones most affected by the different effective dates of IFRS 4 and IFRS 9).*

EFRAG's response

EFRAG supports both the overlay approach and the temporary exemption from applying IFRS 9 as complementary solutions in addressing the misalignment between the effective dates of IFRS 9 and the new insurance contracts Standard. This is because we are aware that both approaches would apply to different entities, depending on their circumstances.

Questions 2 (a) and 2 (b)

16 EFRAG assesses that the temporary exemption from applying IFRS 9 resolves all the issues related to the misalignment between the effective dates of IFRS 9 and the new insurance contracts Standard as described in EFRAG's endorsement advice on IFRS 9. This is because the relevant entities would still be able to apply IAS 39 and IFRS 4 and as a result there would not be additional accounting mismatches in profit or loss, users would not suffer from an unnecessary breach of consistency in financial reporting and any additional cost due to a successive implementation of the two standards would be avoided.

17 In contrast, the overlay approach only provides a solution for the accounting mismatches. The overlay approach does not address the successive implementation (and the related costs) of two accounting standards which for the insurance business are closely related to each other. Furthermore, it generates supplementary costs of its own, due to the necessary dual bookkeeping for the eligible assets under IAS 39 and IFRS 9 that is required at financial asset level and the related supplementary internal controls.

18 EFRAG has nevertheless been made aware that, given the diversity of circumstances among reporting entities which issue insurance contracts within the scope of IFRS 4, the overlay approach is a suitable solution for some banks which

carry out insurance activities, despite the supplementary costs that it triggers. Indeed, for such entities, addressing the accounting mismatches without delaying the implementation of IFRS 9 may be the best option. Consequently, based on the above, EFRAG agrees that both solutions should be pursued and should remain optional.

Question to constituents

19 In its preliminary outreach, EFRAG has encountered existing, albeit limited, appeal for the overlay approach. Does your company wish to apply the temporary exemption from IFRS 9 or the overlay approach? Please explain the circumstances determining your view.

Question 3 – The overlay approach

Paragraphs 35A–35F and BC32–BC53 describe the proposed overlay approach.

(a) Paragraphs 35B and BC35–BC40 describe the assets to which the overlay approach can be applied. Do you agree that the assets described (and only those assets) should be eligible for the overlay approach? Why or why not? If not, what do you propose instead and why?

(b) Paragraphs 35C and BC48–BC50 discuss presentation of amounts reclassified from profit or loss to other comprehensive income in applying the overlay approach. Do you agree with the proposed approach to presentation? Why or why not? If not, what do you propose instead and why?

(c) Do you have any further comments on the overlay approach?

Notes to constituents

20 *The ED proposes that:*

(a) A reporting entity should be permitted to make an adjustment in respect of financial assets that meet both of the following criteria:

(i) *The financial assets are designated as relating to contracts that are within the scope of IFRS 4; and*

(ii) *The financial assets are classified as FVPL in accordance with IFRS 9 and would not have been classified as FVPL in their entirety in accordance with IAS 39.*

(b) An entity should be allowed to designate financial assets that relate to contracts within the scope of IFRS 4 and disclose their policies for selecting such financial assets.

(c) Entities would not be able to include in the overlay approach assets clearly held in respect of activities other than those associated with contracts within the scope of IFRS 4.

(d) Entities are not required to apply the overlay approach to all eligible financial assets that relate to contracts within the scope of IFRS 4.

(e) Entities that apply the overlay approach are required to apply IFRS 9 in full. However, the incremental effect of measuring qualifying assets at fair value through profit or loss rather than applying IAS 39 is removed from pre-tax profit or loss and reported in other comprehensive income.

(f) *The ED proposes that entities that apply the overlay approach should present the amount reclassified from profit or loss to OCI as a separate line item in the statement of profit or loss, OCI or both.*

EFRAG's response

EFRAG considers that the ED has correctly identified the financial assets that should be eligible for the overlay approach. We do however consider that:

(a) The eligibility criteria for the overlay approach should be enhanced including detailed examples that would assist entities in interpreting the criteria; and

(b) Flexibility in presentation should be reduced and presentation requirements should be clearer.

EFRAG also has concerns about the practical applicability of the overlay approach due to the expected supplementary costs that its implementation could imply for institutions.

Question 3 (a)

21 As indicated in paragraph BC32 of the Basis for Conclusions of the ED, the overlay approach has been developed to address the concern raised by the additional accounting mismatches that would arise in profit or loss as a result of applying IFRS 9 before the new insurance contracts Standard for a very specific type of eligible financial assets. A financial asset qualifies for the overlay approach if and only if the following criteria are met:

(a) It is designated as relating to contracts that are within the scope of IFRS 4; and

(b) It is measured at fair value through profit or loss applying IFRS 9 but would not have been measured at fair value through profit or loss, in its entirety, applying IAS 39.

22 EFRAG agrees with the eligibility criteria established by the IASB in paragraph 35B of the ED for the overlay approach because it addresses the concern about the additional accounting mismatches in profit or loss that would potentially arise from the implementation of IFRS 9 in advance of the new insurance contracts Standard.

23 EFRAG also agrees with the proposal to limit the eligibility criteria of the overlay approach to those financial assets relating to contracts that are within the scope of IFRS 4 because these are the only financial assets likely to create additional accounting mismatches in profit or loss as a result of the application of IFRS 9 and IFRS 4. Those financial assets that are not within the scope of the overlay approach must be classified and measured under IFRS 9 and consequently any accounting mismatch in profit or loss would have been resolved on transition to IFRS 9.

24 EFRAG is concerned about the clarity of the wording "*as relating to contracts that are within the scope of IFRS 4*". EFRAG understands the reasons, stated in paragraph BC36 of the Basis for Conclusions of the ED, for not restricting the application of the overlay approach to financial assets that are contractually linked to contracts within the scope of IFRS 4. However, the actual wording in the ED could be interpreted as meaning a strict test of relationship of a financial asset to an insurance contract within the scope of IFRS 4 or, alternatively, as relating to all financial assets other than those that are related to liabilities outside the scope of IFRS 4 as, for example, those surplus assets that an insurance entity holds in the normal course of carrying out insurance activities, either to meet regulatory

requirements or their internal capital requirements. The two interpretations lead to significantly different outcomes.

25 In addition, entities applying the overlay approach determine which financial assets relate to contracts within the scope of IFRS 4. In some cases, it could be easy to identify financial assets relating to particular contracts within the scope of IFRS 4, e.g. where those contracts reference specific financial assets, or where the entity allocates financial assets for particular portfolios of contracts that are within the scope of IFRS 4. However, there may also be situations in which the relationship between financial assets and contracts within the scope of IFRS 4 is unclear.

26 Therefore, EFRAG recommends the inclusion of detailed examples that could allow entities to have a better understanding of the applicability of the overlay approach.

Question 3 (b)

27 As indicated in paragraph 35C of the ED, EFRAG notes that the overlay approach requires the presentation of the amount reclassified from profit or loss to OCI as a separate line item in the statement of profit or loss, OCI or both net of related tax effects. The effect on line items in profit or loss of the amount reclassified from profit or loss to OCI is disclosed either on the face of the statement of profit or loss or in the notes to the financial statements.

28 Based on the previous paragraph, EFRAG understands that an entity that elects to apply the overlay approach will have a number of presentation alternatives including:

(a) Alternative A where the revenues and expenses related to the eligible financial assets would first be determined in accordance with the measurement criteria of IFRS 9 before an adjustment is made, both in profit or loss and in OCI, to add or eliminate the difference between the fair value of the eligible financial assets under IFRS 9 and the amortised cost of the same eligible financial assets in accordance with IAS 39 (the ‘overlay adjustment’); and

(b) Alternative B where the revenues and expenses related to the eligible financial assets would first be determined in accordance with the measurement criteria of IAS 39 before the overlay adjustment is made, in profit or loss or in OCI (subject to further clarification as requested below), to align the measurement of the eligible financial assets with its values under IFRS 9.

29 EFRAG notes that there appears to be a contradiction between paragraph 35A and 35C of the ED. Paragraph 35C states that the overlay adjustment should be presented in profit or loss, other comprehensive income *or both* while paragraph 35A states that there should be a reclassification of the overlay adjustment from profit or loss to other comprehensive income. Therefore, EFRAG considers that clarification of these paragraphs is needed.

30 EFRAG is concerned about the flexibility brought by the possible ways of presenting the overlay adjustment. In general terms, EFRAG does not support unrestricted options in presentation because they create a lack of comparability. Even in a context where different optional approaches already exist, EFRAG considers that additional limitations to comparability are best avoided. EFRAG is therefore concerned that entities would have different options to present the overlay adjustment in the statement of comprehensive income. This leads EFRAG to identify its preferred option as follows.

31 EFRAG considers that Alternative A has the advantage of aligning the recognition basis of the eligible financial assets in profit or loss with the statement of financial position, i.e. based on IFRS 9. In addition, the overlay adjustment could be understood more easily by users of financial statements as no translation from

IAS 39 to IFRS 9 is required in individual line items because profit or loss before the overlay adjustment is based on IFRS 9. However, Alternative A would have the following disadvantages:

(a) Not achieving comparability of financial statements within the insurance sector with those entities applying the temporary exemption from IFRS 9; and

(b) Misalignment between the accounting (external reporting) and the way these assets currently are being reported internally, i.e. based on IAS 39.

32 Alternative B would have the advantage that the financial assets within the scope of the overlay are being presented in profit or loss in the same way that these assets are currently being reported internally, i.e. based on IAS 39. This approach may also reduce the breach in consistency arising from successive changes that reduces complexity for users of financial statements. In addition, it would ensure comparability within the insurance industry with insurers applying the temporary exemption from IFRS 9. Alternative B would have the following disadvantages:

(a) Requiring an extra disclosure explaining the overlay adjustment to users of financial statements; and

(b) Misalignment between the recognition bases of the eligible financial assets in in the statement of comprehensive income with the statement of financial position, i.e. based on IFRS 9.

33 EFRAG has identified that entities may be attracted to the overlay approach because they have identified that not delaying the implementation of IFRS 9 is the best option for them. A presentation that is as consistent as feasible with IFRS 9 is preferable. Consequently, EFRAG prefers Alternative A because it does not bring additional complexity and also because the overlay approach requires the application of IFRS 9, in full.

34 Furthermore, additional disclosures would be required in order to comply with the requirements in IAS 1 *Presentation of Financial Statements*. EFRAG notes that the wording of the ED: *"…as a separate line item…"* is not aligned with the IAS 1 paragraphs 92 to 96 that indicate that: *"An entity shall disclose reclassification adjustments [to profit or loss] relating to components of OCI."* This encompasses the following:

(a) Allocation of tax between items that might be reclassified to profit or loss and those that will not be reclassified to profit or loss; and

(b) Specification of reclassification adjustments (for example on disposal of a foreign operation or in case of cash flow hedges of forecasted cash flows).

Question 3 (c)

35 EFRAG agrees with paragraph BC53 of the Basis for Conclusions of the ED which states that applying the overlay approach would be more costly than applying only IFRS 9. However, EFRAG understands that the costs could be greater than acknowledged by the IASB in paragraph BC53, i.e., keeping track of impairment performed under both IAS 39 and IFRS 9 of designated financial assets.

36 The overlay approach does not avoid the supplementary cost of implementing IFRS 9 and then review the implementation. Furthermore, in applying the overlay approach, both IFRS 9 and IAS 39 would need to be run in parallel for the assets to which the overlay approach is applied. Based on preliminary outreach, EFRAG understands that entities may need to develop new data-processing systems, (to support two systems) and set up new internal controls and performance assessment processes. This could imply costs on top of the costs incurred in implementing

IFRS 9 in full just for a short period of time. These extra costs can be grouped as follows:

(a) *Reassessment of the use of the fair value option and of the business models on transition to the new insurance contracts Standard*: Entities that issue contracts that are within the scope of IFRS 4 will need to consider the possibility of accounting mismatches between IFRS 9 and their current accounting for insurance contracts when implementing the overlay approach and this is the supplementary cost for preparers. They will then need to reassess the application of IFRS 9 when the new insurance contracts Standard becomes effective in order to reflect their asset-liability management appropriately. The new insurance contracts Standard cannot be fully analysed in advance, and when combined with IFRS 9 will require an entity to reassess the classifications of the assets and the underlying investment strategy.

(b) *Implication of running two accounting systems in parallel for the eligible financial assets:* The overlay adjustment would imply maintaining IAS 39 information to determine the overlay adjustment for those very specific assets within the scope of the overlay approach as described above. For example, applying the overlay approach will lead to the implementation of the expected credit loss model for financial assets not subject to the overlay adjustment and the continuing use of the incurred loss model for assets subject to the overlay adjustment as well as the calculation of any relevant shadow accounting (because the overlay approach would be calculated after shadow accounting). This would also have implications over the closing process as the information would need to be processed under both systems to avoid timeliness and reliability concerns. Additionally, insurance entities would have to keep some of the 'old' data warehouses and IT systems running to be able to capture the data to calculate the overlay adjustment.

(c) *Other costs*: The overlay adjustment will imply maintaining IAS 39 internal processes and systems for audit and internal control purposes.

37 EFRAG understands that the concerns raised above could discourage some from applying the overlay approach. However, EFRAG has also been made aware that others wish to apply the overlay approach to specific categories of financial assets such as equity holdings presently classified as available for sale.

Question to constituents

Please respond to these questions in light of the preamble to this draft comment letter highlighting that EFRAG is seeking facts and evidence as assistance in helping finalise its assessments and proposals.

Application of the overlay approach

38 Do you agree with the extra costs identified in paragraph 36? If so, do you consider these costs to be significant? Please explain and provide quantifications to the extent possible.

39 Do you consider that the application of the overlay approach will imply that such extra costs as stated in paragraph 36 above will limit its applicability? If so, could you identify and quantify, if possible, which extra costs (on top of implementing IFRS 9) are the most significant?

40 Other than costs, are there any other reasons why an insurer would not elect to apply the overlay approach?

41 If you elect to apply the overlay approach, would you change the way the eligible financial assets are being reported internally?

Presentation

42 Do you agree that the optionality in presentation should be limited to Alternative A as stated in paragraph 28 above?

43 Referring to paragraph 34 above, do you consider that the amendments to IFRS 4 which may arise due to the ED should include further explanation about the presentation of the overlay adjustment in OCI?

Question 4 – The temporary exemption from applying IFRS 9

As described in paragraphs 20A and BC58–BC60 the ED proposes that only entities whose predominant activity is issuing contracts within the scope of IFRS 4 can qualify for the temporary exemption from applying IFRS 9.

(a) Do you agree that eligibility for the temporary exemption from applying IFRS 9 should be based on whether the entity's predominant activity is issuing contracts within the scope of IFRS 4? Why or why not? If not, what do you propose instead and why?

As described in paragraphs 20C and BC62–BC66, the ED proposes that an entity would determine whether its predominant activity is issuing contracts within the scope of IFRS 4 by comparing the carrying amount of its liabilities arising from contracts within the scope of IFRS 4 with the total carrying amount of its liabilities (including liabilities arising from contracts within the scope of IFRS 4).

(b) Do you agree that an entity should assess its predominant activity in this way? Why or why not? If you believe predominance should be assessed differently, please describe the approach you would propose and why.

Paragraphs BC55–BC57 explain the IASB's proposal that an entity would assess the predominant activity of the reporting entity as a whole (i.e. assessment at the reporting entity level).

(c) Do you agree with the proposal that an entity would assess its predominant activity at the reporting entity level? Why or why not? If not, what do you propose instead and why?

Notes to constituents

44 *In determining which reporting entities should be permitted to apply the temporary exemption from applying IFRS 9, the IASB placed more weight on ensuring that the temporary exemption from applying IFRS 9 could not be applied by entities that have non-insurance activities (for example, entities with banking activities) than on ensuring that all insurance-related assets are included within the scope of the temporary exemption from applying IFRS 9. Hence, the ED proposes that the temporary exemption from applying IFRS 9 should only be available to entities whose predominant activity is issuing contracts within the scope of IFRS 4.*

45 *The ED does not propose a quantitative threshold for predominance. However, the IASB notes that the temporary exemption from applying IFRS 9 is targeted at the entities that are most significantly affected by the different effective dates of IFRS 9 and the new insurance contracts Standard, because they engage purely in activities that result in contracts within the scope of IFRS 4. It is not designed to apply to entities that engage in activities other than issuing contracts within the scope of IFRS 4, for example, banking or asset management activities.*

46 *Accordingly, 'predominance' is intended to be a high threshold. For example, if three-quarters of an entity's liabilities are liabilities arising from contracts within the*

scope of IFRS 4 and one-quarter are liabilities arising from other activities, that entity would not, for the purposes of the ED, meet the predominance condition.

47 *The ED proposes that entities should assess whether they are eligible for the temporary exemption from applying IFRS 9 at the reporting entity level rather than below the reporting entity level because it:*

(a) *Is easier for users to understand because it does not result in the simultaneous application of IFRS 9 and IAS 39 by the same reporting entity.*

(b) *Captures a relatively narrow population of entities and, therefore, maximises the number of entities required to apply the improved accounting required by IFRS 9.*

(c) *Is simpler for preparers to apply and users to understand because it avoids the need for accounting requirements for transfers of financial instruments between those parts of a reporting entity that qualify for the temporary exemption from applying IFRS 9 and those that do not.*

EFRAG's response

As the temporary exemption from applying IFRS 9 helps mitigate all negative effects of the misalignment of the effective dates of IFRS 9 and the new insurance contracts Standard, EFRAG considers that it should be available to all entities undertaking insurance activities, so as to avoid breaching the level playing field in the insurance sector. EFRAG further considers that the temporary exemption from applying IFRS 9 should not capture non-insurance activities, "banking" activities in particular. In this area, EFRAG is more demanding than the IASB as in its view the final requirements should not allow any material banking activities to be subject to the temporary exemption from applying IFRS 9. EFRAG therefore disagrees with the IASB's decision to "only capture a relatively narrow population of entities" (paragraph BC60) or to limit the temporary exemption from applying IFRS 9 "at reporting entity level" (paragraph BC57). EFRAG furthermore considers that the temporary exemption from applying IFRS 9 should only be available to entities that issue material insurance contracts within the scope of IFRS 4.

To achieve these objectives, EFRAG considers that the scope of the temporary exemption from applying IFRS 9 should be guided by the identification of "insurers" or "insurance activities", focusing on how they can be identified in practice. This leads EFRAG to consider approaches that are both broader and more restrictive than proposed by the IASB (as an attempt at making all insurance activities qualify and excluding other activities, in particular banking activities) and could be applied below the reporting entity level. EFRAG therefore considers that the IFRS 4 amendments should be finalised on one of the two following approaches:

(i) A widened "predominant activity" criterion however set at a higher level than proposed by the IASB; and

(ii) The "regulated entity" criterion.

General comments

48 In EFRAG's view, the objective of the IFRS 4 amendments are to address the concerns also identified by EFRAG in its endorsement advice to the European Commission and mentioned in response to Question 1 above, i.e. avoid the additional accounting mismatches that the implementation of IFRS 9 would trigger, avoid successive breaches in consistency of financial reporting that create

complexity for users and avoid the supplementary costs due to an implementation of IFRS 9 in stages, on the basis of both the current and the new insurance contracts Standards. EFRAG observes that the temporary exemption from applying IFRS 9 is the only approach that eliminates all these difficulties. Consequently, and in order to keep a level playing field in the insurance sector, EFRAG considers that this approach should be available to all entities which carry insurance activities. EFRAG therefore does not support the IASB's proposals which would deliberately "only capture a relatively narrow population of entities" (paragraph BC60). However, in EFRAG's view, all material non-insurance activities, in particular banking activities should be subject to IFRS 9 as IFRS 9 brings significant improvements in financial reporting. Consequently, EFRAG does not support a delay in the implementation of IFRS 9 for these non-insurance activities. We note that whilst the IASB has paid attention to this constraint, it has not made proposals that totally avoid material banking activities being captured within the scope of the temporary exemption from applying IFRS 9.

49 EFRAG firmly considers that any approach that will succeed in meeting the objective of (1) making the temporary exemption from applying IFRS 9 available to all insurance activities; (2) avoiding applying the temporary exemption from applying IFRS 9 to material banking activities, is one that will focus on identifying "insurers" more broadly rather than focussing on contracts within the scope of IFRS 4 alone and that can be applied below reporting entity level.

50 As IFRS generally is based on transactions rather than industries, we can find no IFRS definition that would assist in scoping the temporary exemption from applying IFRS 9. Similarly to the IASB, however in a manner consistent with the objectives that EFRAG has identified, EFRAG has investigated two approaches, as is explained below, that characterise "insurers" in a manner as close as possible to how they can or are identified in practice.

51 In doing so, EFRAG has considered two different approaches:

(a) Approach 1: a widened "predominant activity" criterion however set at a higher level than proposed by the IASB; and

(b) Approach 2: the "regulated entity" criterion.

52 Based on these two approaches, EFRAG's answers to Questions 4(a), 4(b) and 4(c) are as follows.

Question 4 (a) - Temporary exemption from applying IFRS 9 based on an entity's predominant activity of issuing contracts within the scope of IFRS 4

53 In EFRAG's view, entities which do not issue insurance contracts in the scope of IFRS 4 do not encounter any additional implementation difficulty that would justify a temporary exemption from applying IFRS 9. Therefore, EFRAG considers that the issuance of material contracts within the scope of IFRS 4 is a necessary condition for the application of the temporary exemption of applying IFRS 9. As is explained in our response to the following question, the focus of the IASB on this criterion alone results in a scope that is so limited that it does not meet the objectives which have been highlighted in our general comments above.

54 Please note that the comments we provide in response to the next question on the temporary exemption are to be read as applying only to entities that issue material insurance contracts in the context of IFRS 4.

Question 4 (b) – Predominance condition as proposed by the IASB

55 As explained above, a successful approach in scoping the temporary exemption from applying IFRS 9 is one that will capture all insurance activities, and only insurance activities. As illustrated in Appendix 2 to this letter, the survey conducted by EFRAG Secretariat on the basis of publicly available financial reports indicates that the approach proposed by the IASB is overly restrictive.

56 We have therefore investigated the two following approaches applicable at or below reporting entity level:

<u>Approach 1: a widened "predominance activity" criterion</u>

57 EFRAG considers that the "predominance criterion" based on a ratio of total liabilities may be a way of identifying "insurers", however the definition of the ratio would need to be revisited so as to encompass virtually all liabilities that an "insurer" might carry on its balance sheet. This would allow setting the threshold at a higher level than proposed by the IASB. Doing so helps in two ways:

(a) The criterion helps capture as large a population as possible, i.e. meets the objective of avoiding breaches in level playing field; and

(b) Setting the criterion at a level that is substantially higher than currently considered by the IASB helps avoid capturing material banking activities.

58 EFRAG observes that the activities of insurers are not limited to issuing insurance contracts within the scope of IFRS 4. Insurers also provide asset management services, provide for premium rebates (amounts to be paid back to the policyholder), undertake hedging activities, issue debt to finance insurance activities, may have written put options over non-controlling interest and have operating liabilities such as deferred tax and employee benefit liabilities.

59 For these reasons, in determining the numerator of the predominance criterion EFRAG considers that all of the liabilities an insurer is expected to carry should be captured, including those mentioned above. EFRAG considers that, when comparing the widened predominant activity criterion to the proposal in the ED, this widened criterion better reflects the set of activities that an insurer routinely performs, rather than the proposal in the ED that bases the predominance criteria on a relevant, however restrictive, subset of insurance activities.

60 In widening the predominance criterion, EFRAG has considered that for liabilities outside the scope of IFRS 9, the temporary exemption from applying IFRS 9 would have no effect. In addition, EFRAG has considered that for those asset management activities which are accounted for at fair value through profit or loss, and hedging derivatives at fair value through profit or loss, the change from IAS 39 to IFRS 9 would bring no change. For these reasons, EFRAG has considered that widening the predominance criterion would have no negative effects, i.e. would not unduly delay improvements that IFRS 9 can bring beyond the accounting for financial assets that back insurance contracts within the scope of IFRS 4.

61 When the predominant activities of an insurer are widened as described above, EFRAG would expect that the predominance ratio could be increased to a level that is substantially higher than the one identified by the IASB in its Basis for Conclusions. This should avoid, as indicated above, that the temporary exemption from applying IFRS 9 being applied to material non-insurance activities.

62 In EFRAG's view, in the case of mixed groups, the redefined predominance criterion hence redefined should not be tested at reporting entity level only. If tested at below reporting entity level, it would help identify a sub-group of entities that would to a material extent issue insurance contracts within the scope of IFRS 4 and pass the

test or a sub-group of entities that do not pass the test (such as credit institutions). As a consequence, the objective of applying IFRS 9 to all material non-insurance activities and exempting material insurance activities would be met: the temporary exemption from applying IFRS 9 would only apply to insurance activities as captured through the predominance test.

63 With respect to reassessment, the ED proposes that after initial application of the temporary exemption from applying IFRS 9, an entity should be required to reassess whether insurance activities are predominant if there is a demonstrable change to the entity's corporate structure. If after the reassessment, the entity has insurance activities which are no longer predominant, the ED proposes that the entity should apply IFRS 9 in the next reporting period. Subsequently, such an entity would be permitted but not required to apply the overlay approach to its eligible financial assets.

64 EFRAG agrees that changes in corporate structure may take long in its preparation and thus an entity would know well in advance when the change is to occur. EFRAG additionally acknowledges that the implementation of IFRS 9 is estimated to take two to three years which implies that if an entity would rely on the temporary exemption from applying IFRS 9 until 1 January 2021 (assuming the IASB does not finalise the new insurance contracts Standard sooner) the entity would have to start its implementation process for IFRS 9 during 2018 or 2019 at the latest. Furthermore, this would ensure that a change in corporate structure that would bring banking activities within the temporary exemption from applying IFRS 9 would be prevented. For these reasons, EFRAG agrees that when a change in corporate structure takes place during this short interim period, an entity is to apply IFRS 9 from the beginning of the next annual reporting period.

<u>Approach 2: the "regulated entity" criterion</u>

65 In defining insurers, EFRAG proposes to rely on the following definitions[1]:

(a) An 'insurance undertaking' is defined as 'a direct life or non-life insurance undertaking which has received authorisation from the supervisory authorities' and is supervised by them; and

(b) A 'reinsurance undertaking' is defined as 'an undertaking which has received authorisation from the supervisory authorities to pursue reinsurance activities' and is supervised by them.

66 EFRAG notes that in all material jurisdictions insurance activities fall within the remit of relevant supervisory authorities.

67 Legal entities which are regulated could then apply the temporary exemption from applying IFRS 9 in their individual financial statements and also in their contribution to the consolidated financial statements of a reporting entity, i.e. the accounting would be rolled-up into the consolidated financial statements. Conversely, non-insurance regulated legal entities included in the consolidated financial statements of an insurance-regulated reporting entity would not be allowed to apply the temporary exemption from IFRS 9. The above would in addition be applied considering the general materiality threshold.

[1] EFRAG considers the definitions proposed as operable as they have been derived from European regulatory sources. However, as the derived definitions do not contain any specific European characteristics, EFRAG considers that these could be used in a global setting.

68 Credit institutions and financial institutions in particular would not benefit from the temporary exemption. EFRAG believes this creates a level playing field for the activities undertaken by these entities.

69 In forming this proposal, EFRAG has considered the following definitions of a credit institution and a financial institution.

(a) A credit institution means an undertaking the business of which is to take deposits or other repayable funds from the public and to grant credits for its own account.

(b) A financial institution means an undertaking other than a credit institution, the principal activity of which is to acquire holdings or to carry one or more activities such as lending, financial leasing, payment services and trading for own account or for account of customers (e.g. in transferable securities). The definition of financial institutions includes financial holding companies, mixed financial holding companies, payment institutions and asset management companies, but excludes insurance holding companies and mixed-activity insurance holding companies.

Questions to constituents

Please respond to these questions in light of the preamble to this draft comment letter highlighting that EFRAG is seeking for facts and evidence helping finalise its assessments and proposals.

Widened predominance criterion

70 How restrictive is the assessment of predominance as proposed by the IASB? Please provide quantitative evidence.

71 Would the proposal in paragraphs 57 – 64 above achieve the objectives highlighted by EFRAG (i.e. avoid a breach in level playing field in the insurance sector and inclusion of banking activities)? If not, what formula would you recommend for the assessment of predominance, and why?

72 Do you think that the proposal above leads to a predominance criterion that is practical, auditable and comparable? Please explain.

73 Taking into account the widening of the predominance criterion, do you agree that the quantitative threshold should be at a level that is substantially higher than three-quarters of an entity's total liabilities? Please explain.

The "regulated entity" criterion

74 Do you agree with the arguments in paragraphs 65– 69 above? If you do not and still believe that the regulated criterion has a role to play, please explain why and how it would work.

75 Is the regulatory consolidation scope always identical to the IFRS consolidation scope? If not, please explain the difference(s).

General

76 EFRAG currently considers that eligibility for the temporary exemption of IFRS 9 requires that entities/activities issue material insurance contracts within the scope of IFRS 4. Do you agree with this materiality threshold? If not, what do you suggest instead? Please explain.

77 Is this condition necessary when relying on the "regulated entity" criterion? What are the circumstances in which an entity would be supervised by an insurance regulator and not issue insurance contracts within the scope of IFRS 4? What are the effects of changing from IAS 39 to IFRS 9 to those entities?

78	If you consider that eligibility for the temporary exemption from applying IFRS 9 should not be based on predominance or on regulation, what principle(s) should be applied, and how would you test these principles?

Question 4 (c) - Whether to assess predominance at the reporting entity level

79 Both approaches considered by EFRAG (i.e. the widened "predominant activity" criterion and the regulated entity criterion) result in application either at or below reporting entity level for the reasons explained in the paragraphs above. EFRAG has considered the arguments of the IASB, who is against below reporting entity level, which are:

(a) Avoiding a breach in uniformity of accounting policies; and

(b) Accounting for transfers and avoiding earnings management.

Avoiding a breach in uniformity of accounting policies

80 EFRAG agrees with the IASB that a breach in uniformity of accounting policies is best avoided. However, the temporary exemption from applying IFRS 9 is a response to exceptional circumstances that call for pragmatic solutions that can be supported as short-term interim measures.

81 In the present circumstances, EFRAG notes that both IFRS 9 and IAS 39 make use of the same measurement bases: amortised cost and fair value, with fair value changes being presented in profit or loss or other comprehensive income. IFRS 9 has the merit of bringing an improved discipline in how the different measurement bases apply, notably with the reference to the business model. A temporary exemption from applying IFRS 9 can result in users being presented with, in consolidated financial statements, a segregation between financial assets accounted for in accordance with IAS 39 and which participate in the asset management activity of the insurance activities of the group, while all others are reported in accordance with IFRS 9. It is not ideal, however proper presentation and disclosure can help meet the objective assigned to the interim solution.

Transfers

82 EFRAG agrees with the statement in paragraph BC57 (b) of the ED that application of the temporary exemption from IFRS 9 below the reporting entity level has raised concerns of earnings management. For this reason, EFRAG has paid special attention to the accounting for transfers of financial assets between an IAS 39 environment and an IFRS 9 environment and vice versa within a reporting entity and has considered the following alternatives.

(a) Retaining the original gross carrying amount;

(b) Transfers at fair value;

(c) Application of a tainting rule; and

(d) An asymmetrical tainting rule.

83 The above alternatives were rejected on the basis of the creation of an impact on profit or loss by internal transactions, complexity or cost.

84 In dealing with transfers from financial assets from IAS 39 to IFRS 9, EFRAG considers that the transition guidance in IFRS 9 can be used.

85 EFRAG considers that when transfers of financial assets occur, the transferred assets should follow the origination accounting in order to avoid earnings management. For example, when a transfer is from IFRS 9 to IAS 39, the original accounting (IFRS 9) would follow the financial instrument being transferred. While

complex, EFRAG assesses that the benefit of avoidance of earnings management outweighs the complexity concerns.

86 This would avoid an entity having any gains or losses arising from an internal transfer. The entity would also not need to change its accounting for the financial assets involved when such a transfer takes place. This approach would, however, create complexity in that identical assets used for identical purposes could be measured in different ways.

87 EFRAG additionally proposes that transferred financial assets should be presented separately in the statements of financial position and comprehensive income, and separate disclosures should provide a reconciliation between the two accounting environments. These measures should avoid earnings management taking place.

Questions to constituents

88 Should an entity assess its predominant activity at the reporting entity level or below the reporting entity level or both? Please explain your view.

89 In your view, how can the temporary exemption from applying IFRS 9 below the reporting entity level be determined in a way that ensures the eligibility of relevant entities and allows for comparability between entities? Please explain your view.

90 What are the expected costs involved in the implementation of the temporary exemption from applying IFRS 9 at reporting entity level or below reporting entity level (including disclosures)? Please provide evidence, including quantitative evidence to the extent feasible.

91 Which alternative for the accounting of transfers as stated in paragraph 82 to 87 above would be most appropriate for the temporary exemption from applying IFRS 9 below reporting entity level? Please explain why.

Question 5 – Should the overlay approach and the temporary exemption from applying IFRS 9 be optional?

As explained in paragraphs BC78–BC81, the ED proposes that both the overlay approach and the temporary exemption from applying IFRS 9 should be optional for entities that qualify. Consistently with this approach, paragraphs BC45 and BC76 explain that an entity would be permitted to stop applying those approaches before the new insurance contracts Standard is applied.

(a) Do you agree with the proposal that the overlay approach and the temporary exemption from applying IFRS 9 should be optional? Why or why not?

(b) Do you agree with the proposal to allow entities to stop applying the overlay approach or the temporary exemption from applying IFRS 9 from the beginning of any annual reporting period before the new insurance contracts Standards is applied? Why or why not?

Notes to constituents

92 *The ED proposes that the overlay approach and the temporary exemption from applying IFRS 9 should be permitted but not required for entities that issue contracts within the scope of IFRS 4.*

93 *The IASB acknowledges that making the overlay approach and the temporary exemption from applying IFRS 9 optional could reduce comparability between entities. However, the IASB expects that this concern would be mitigated by the disclosure requirements proposed. In addition, the IASB expects that any reduction in comparability would only exist for a short period of time.*

94 *An entity can stop using the overlay approach and the temporary exemption from applying IFRS 9 at the beginning of any annual reporting period.*

EFRAG's response

EFRAG agrees that both the overlay approach and the temporary exemption from applying IFRS 9 should be optional due to the diversity of circumstances encountered in reporting entities that issue insurance contracts. EFRAG also agrees to permit entities to stop applying the overlay approach or the temporary exemption from applying IFRS 9 before the effective date of the new insurance contracts Standard because no entity should be prevented from benefiting from the improvements brought by IFRS 9 when its circumstances permit them to do so.

Question 5 (a)

95 Due to the diversity of insurance contracts across the insurance industry, some entities issuing insurance contracts may find it more beneficial to apply IFRS 9, whereas others may consider that applying either the overlay approach or the temporary exemption from applying IFRS 9 provides more relevant information in their circumstances.

96 EFRAG acknowledges that there would be a lack of comparability between financial statements of entities that issue insurance contracts as a result of permitting several options rather than requiring one or the other. There would also be a lack of comparability with entities that do not carry insurance contracts within the scope of IFRS 4. Furthermore, in the context of a temporary remedy and given the difficulties created by the misalignment of the effective dates of IFRS 9 and the new insurance contracts Standard and the diversity of circumstances that various reporting entities may encounter, EFRAG considers that the proposed approaches are best offered on an optional basis.

97 Therefore, EFRAG agrees with the proposals that the temporary exemption from applying IFRS 9 and overlay approach should be permitted rather than required. However, EFRAG recommends that the disclosure requirements for the overlay approach are enhanced by requiring disclosures relating to the fact that an entity has ceased to apply the overlay approach and the reasoning for ceasing the approach. This is because, EFRAG considers that these disclosures would facilitate the understanding by users of the entity's financial statements.

Question 5 (b)

98 The rationale for permitting a temporary exemption from applying IFRS 9 and the overlay approach would no longer exist when an entity applies the new insurance contracts Standard. Consequently, EFRAG agrees that an entity should be required to stop applying the temporary exemption from applying IFRS 9 and the overlay approach when it applies the new insurance contracts Standard, if their circumstances have changed and no longer justify a delay in the implementation of IFRS 9 that keeps their financial reporting away from the improvements brought by IFRS 9.

99 In relation to the overlay approach:

(a) When an entity ceases to apply the overlay approach, it ceases it on a reporting entity level and any accumulated OCI is transferred into retained earnings as if the overlay approach had never been applied.

(b) When an entity voluntarily designates or mandatorily de-designates individual financial assets from the overlay approach, it does so on an asset by asset basis and any accumulated OCI is transferred into profit or loss.

100 EFRAG is concerned that these different treatments may allow some degree of earnings management. However, EFRAG accepts that this cannot be easily resolved for a situation that is expected to be very short-term. Therefore, EFRAG agrees to permit entities to stop applying the overlay approach before the new insurance contracts Standard is applied for the reasons provided in paragraph 98 above.

Question 6 – Expiry date

Paragraphs 20A and BC77 propose that the temporary exemption from applying IFRS 9 should expire at the start of annual reporting periods beginning on or after 1 January 2021.

Do you agree that the temporary exemption from applying IFRS 9 should have an expiry date? Why or why not?

Do you agree with the proposed expiry date of annual reporting periods beginning on or after 1 January 2021? If not, what expiry date would you propose and why?

Notes to constituents

101 *The ED proposes that entities should be prohibited from applying the temporary exemption from applying IFRS 9 for annual reporting periods beginning on or after 1 January 2021. The IASB believes that, even if the new insurance contracts Standard is not effective, all entities should apply IFRS 9 by that date. This is because IFRS 9 represents a significant improvement in the accounting for financial instruments.*

EFRAG's response

EFRAG agrees that the temporary exemption from applying IFRS 9 should have an expiry date as this constitutes a strong incentive for all parties involved in as quick a finalisation of the insurance contracts Standard as feasible. EFRAG also agrees that the expiry date should be reporting periods beginning on or after 1 January 2021 or earlier because EFRAG expects that the effective date of the new insurance contracts Standard will be no later than 1 January 2021. EFRAG however disagrees with the IASB that the overlay approach may be a remedy to a possible postponement to the finalisation of the new insurance contracts Standard.

Question 6 (a)

102 EFRAG is in the view that the temporary exemption from applying IFRS 9 should have an expiry date to ensure that those entities that apply the approach to move to IFRS 9 at some point in time. In addition, EFRAG agrees with the IASB that IFRS 9 brings a distinct improvement over the existing requirements in IAS 39, as stated in its endorsement advice on IFRS 9.

Question 6 (b)

103 EFRAG supports the proposed expiry date for the temporary exemption from applying IFRS 9 of reporting periods beginning on or after 1 January 2021. This is because we expect that the new insurance contracts Standard will be finalised rapidly and we are aware that the IASB is working towards this outcome. EFRAG

considers that setting an expiry date constitutes a strong incentive for all parties involved to contribute to a quick finalisation of the long awaited new insurance contracts Standard. EFRAG would recommend that the expiry date is assessed when the insurance contracts Standard is finalised, and reset at an earlier date if feasible.

104 EFRAG wishes to highlight however that it disagrees with the IASB that the overlay approach would constitute a possible alternative to the temporary exemption from applying IFRS 9 in case the new insurance contracts Standard would not be finalised in time. This is because of the supplementary costs that the overlay approach generates and because, if and where applied, it responds to quite specific circumstances.

Other issues

Applicability for first time adopters

105 Although not explicitly addressed in the Invitation to Comment by the IASB in the ED, EFRAG does not support the consequential amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards* that would prohibit first-time adopters of IFRS from applying the temporary exemption from applying IFRS 9 or the overlay approach. EFRAG does not support this proposal because it would exclude entities that:

(a) Join a group that is applying the temporary exemption from applying IFRS 9 or the overlay approach and where the entity is required to provide a reporting package based on IFRS to the group level; or

(b) Is part of a group that adopts the temporary exemption from applying IFRS 9 or the overlay approach but, at the time of adopting the temporary exemption, is a first-time adopter in its own right.

106 EFRAG assesses that such an exemption would lead to subsidiaries within a group being required to apply both IFRS 9 and IAS 39, leading to excessive costs.

107 Therefore, EFRAG recommends that IFRS 1 permit a first-time adopter to adopt the temporary exemption from applying IFRS 9 or the overlay approach if they are described in paragraph 3(c) of IFRS 1 and prepared a reporting package in accordance with IFRSs for consolidation purposes without preparing a complete set of financial statements as defined in IFRS 1. EFRAG agrees that the temporary exemption from applying IFRS 9 or the overlay approach should not be available to other first-time adopters of IFRS.

APPENDIX 2: Impact of the temporary exemption from applying IFRS 9 on insurance companies

Purpose of this appendix

1 This attachment has been prepared by the EFRAG Secretariat. It provides a summary of the potential impact of the temporary exemption from applying IFRS 9 on the financial statements of major European insurers.

2 The analysis provides Information on the number of insurers that might pass a quantitative test of predominance, based on different interpretations of predominance.

3 The data has been collected from published financial statements for reporting periods ending on 31 December 2014. Given the level at which this public information is summarised, and the short time-frame to conduct the study, it has been necessary to make assumptions about the classification of the reported liabilities. Further, IFRS does not mandate a specific basis for measuring liabilities related to insurance contracts within the scope of IFRS 4 *Insurance Contracts*. As a result, the numbers below can only be taken as a guide, rather than being considered accurate in all respects.

Entities selected

4 The analysis is derived from the financial statements of the 20 largest insurers that published their financial statements in accordance with IFRS as adopted in the EU. "Total assets" was used as the basis for the selection of insurers because it is more likely that assets are measured on a relatively comparable basis compared to other bases such as revenue.

5 All five European insurers classified as "systemically important insurers" by the Financial Stability Board are included in the sample.

6 Six of the insurers are on the 2013 EU financial conglomerate list.

7 Of the 20 insurers analysed:

(a) The 6 financial conglomerates are the top company of their group;

(b) 11 insurers are the top company of their group; and

(c) 3 are not the top company of the group to which they belong.

8 It should be noted that subsequent investigations about whether the temporary exemption from applying IFRS 9 should be provided at or below the reporting entity cannot be based solely on this sample because other conglomerates that are not classified principally as insurers or who do not contain a large insurer may seek access to the temporary exemption from applying IFRS 9.

Predominance test

9 This section considers the number of insurers that would pass a predominance test whereby eligibility for the temporary exemption from applying IFRS 9 depends on the relationship between selected liabilities and total liabilities. The IASB has tentatively decided that "an entity should initially assess whether insurance activities are predominant for the entity based on the level of gross liabilities arising from contracts within the scope of IFRS 4 relative to the entity's total liabilities".

10 As it is not clear how “contracts within the scope of IFRS 4” should be interpreted, the amounts below consider two interpretations:

(a) Contracts that are currently accounted for under IFRS 4; and

(b) Contracts that are currently accounted for under IFRS 4 plus investment contracts that were bifurcated when IFRS 4 was first applied.

11 The third line in the following table provides the impact of the predominance test proposed by EFRAG, i.e., a widened “predominant activity” criterion.

Predominance test	**Number passing the predominance test at:**							
	100%	**>95%**	**>90%**	**>85%**	**>80%**	**>75%**	**>70%**	<=**70**%
IASB								
(a) Accounted for under IFRS 4				2	5	6	11	9
(b) Accounted for under IFRS 4 plus previously bifurcated investment contracts				2	7	10	13	7
EFRAG proposal relating to a widened “predominant activity” criterion	12	17	19	19	19	19	20	